(5) (3) (3)

Nos. 96-1186, 96-1187, 96-1188

Supreme Court, U.S.
FILED
APR 9 1997
CLERK

In The

Supreme Court of the United States

October Term, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,

Petitioners,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF *AMICI CURIAE* OF THE AMERICAN GAS ASSOCIATION AND CITIZEN ACTION

RICHARD VUERNICK
Attorney

EDWIN ROTHSCHILD
Public Affairs/Energy Director

CITIZEN ACTION
1730 Rhode Island Avenue
Washington, D.C. 20036
(202) 775-1580

A. KAREN HILL
Staff Vice President
Counsel of Record

ROGER B. COOPER
Senior Vice President

DAVID MUCHOW
General Counsel and
Corporate Secretary

JANE R. LEWIS
Senior Counsel and
Director

AMERICAN GAS ASSOCIATION
1515 Wilson Boulevard
Arlington, Virginia 22209
(703) 841-8465
Attorneys for the
American Gas Association

35 pp

TABLE OF CONTENTS

Page

Table of Contents ..... *i*

Table of Authorities ..... *iii*

Interest of the *Amici Curiae* 2

Summary of Argument 3

Argument 6

The Lower Court's Decision Unlawfully Allows FERC To Usurp State Authority To Regulate Natural Gas Distributors' Use Of Pipeline Capacity Purchased To Serve Local Retail Consumers 6

A. The Natural Gas Act Preserved the Full Scope of State Regulatory Authority Over LDCs' Activities to Serve Local Retail Consumers and Extended Federal Jurisdiction Only in Areas Where States Constitutionally Cannot Act 6

Page

B. Competition and Open Access Unbundled Transportation Fundamentally Have Altered Commercial Relationships in Natural Gas Markets, But NGA Jurisdiction Remains Circumscribed by State Authority to Regulate Commerce in the Interests of Local Retail Consumers. 9

C. Including LDCs' Release of Capacity to Local Retail Customers Under FERC's Rule Results in Subsidies to Large Users and Marketers from Consumers That the NGA was Intended to Protect. 14

D. States Constitutionally Can Regulate Unbundled Retail Transportation Services and the NGA Left That Authority Undisturbed. 18

Conclusion 20

Page

TABLE OF AUTHORITIES

Cases Cited:

Supreme Court Cases:

General Motors Corp. v. Tracy, Tax Comm'r of Ohio, No. 95-1232 (U.S. Feb. 18, 1997). 6, 10, 12, 18

Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988). 13

Panhandle Eastern Pipe Line Co. v. Public Service Comm'n, 332 U.S. 507 (1947). 6, 18

D.C. Circuit Court Cases:

Maryland People's Counsel v. Fed. Energy Reg. Comm'n, 761 F.2d 768 (D.C. Cir. 1985). 5, 9, 11

Maryland People's Counsel v. Fed. Energy Reg. Comm'n, 761 F.2d 780 (D.C. Cir. 1985). 5, 9, 11

United Distribution Cos. v. Federal Energy Reg. Comm'n, 88 F.3d 1105 (D.C. Cir. 1996). 10

Other Court Cases:

Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n, 77 Pa. Commw. 268, 465 A.2d 735 (1983). 13

Page

Statutes Cited:

15 U.S.C. § 717 - 717(z) (1994). .....*passim*

15 U.S.C. §§ 3301 -3348 (1994). 9

Other Authorities Cited:

Code of Federal Regulations:

18 C.F.R. §284.243 (1996). 15

Federal Energy Regulatory Commission

Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13267, III FERC Stats. & Regs. Preambles ¶ 30,939 (1992) ("Order No. 636"); *Order on Reh'g*, 57 Fed. Reg. 36128, III FERC Stats. & Regs. ¶ 30,950 (1992) ("Order No. 636-A), *Order on Reh'g*, 57 Fed. Reg. 57911, 61 FERC ¶ 61,272 (1992) ("Order No. 636-B"); *Reh'g Denied*, 62 FERC ¶ 61,007 (1993) ("Order No. 636-C), upheld in part and remanded in part, *United Distribution Cos. v. Federal Energy Regulatory Comm'n*, 88 F.3d 1105 (D.C. Cir. 1996); *order on remand*, 78 FERC ¶ 61,186 (Feb. 27, 1996). 10, 11, 14, 15

In The

Supreme Court of the United States

October Term, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,

Petitioners,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF *AMICI CURIAE* OF THE AMERICAN GAS ASSOCIATION AND CITIZEN ACTION

Pursuant to Rule 37.2, the American Gas Association (hereafter "A.G.A.")[1] and Citizen Action (hereafter "Citizen") respectfully submit this brief *amici curiae* in support of the petitions for writ of *certiorari* filed by petitioners Associated Gas Distributors, et al., ("AGD") the Public Service Commission for the State of New York, *et al.*, and the American Public Gas Association, *et al.*("APGA"). The written consents of the parties are attached.

---

1 Public Service Company of North Carolina does not join in this brief.

INTEREST OF THE *AMICI CURIAE*

A.G.A. is a national non-profit trade association representing over 200 local distribution companies (hereafter "LDCs" or "gas distributors") principally engaged in distributing natural gas in the 50 states and the District of Columbia. A.G.A. member companies provide retail gas sales and transportation service to more than 55 million residential, commercial and industrial customers across the nation within state designated service territories.

Citizen Action is a nationwide consumer and environmental watchdog organization with over two million members in 31 states. A large percentage of Citizen Action members are residential consumers of natural gas and are concerned about the availability and price of natural gas supplies.

The question presented by AGD and the state commissions is whether the Federal Energy Regulatory Commission ("FERC" or "the Commission") has jurisdiction over LDCs' release to local retail customers of the rights LDCs have purchased to use pipeline capacity to serve local retail sales customers, even though Sections 1(b) and 1(c) of the Natural Gas Act ("NGA" or "the Act")[2] each expressly grant FERC jurisdiction only where states constitutionally cannot act. Similarly, APGA presents the question whether FERC can regulate municipalities' release of pipeline capacity despite the NGA's unequivocal exemption of municipal gas companies from FERC regulation.

---

[2] 15 U.S.C. § 717 (b) & (c) (1994) (Pet. App. at 1007a - 1009a).

As national associations of local distributors and gas consumers, A.G.A. and Citizen have a particular interest in the preservation of the statutory prohibition of federal jurisdiction to regulate distribution of natural gas. The opinion of the United States Court of Appeals for the District of Columbia Circuit, affirming the Commission's authority over releases of pipeline capacity rights by LDCs to their retail sales customers, eviscerates the jurisdictional scheme codified by Congress in the NGA by undermining the authority of state regulatory agencies and municipalities to regulate effectively local natural gas distribution companies.

A.G.A. and Citizen accordingly submit this brief *amici curiae* urging the Court to issue its writ of *certiorari* to consider this matter.

SUMMARY OF ARGUMENT

FERC has extended its regulation of open access pipeline transportation to the secondary market in transportation, even under circumstances where LDCs seek to release pipeline capacity rights to their own local retail sales customers for whom they have purchased those rights. Under FERC's rules, unless releases are prearranged at the pipeline's maximum tariff rate or are for a month or less duration, releases of capacity by LDCs must be posted on an electronic bulletin board and are auctioned to the highest bidder, subject to a cap equal to the pipeline's maximum monthly tariff rate. FERC's assertion of jurisdiction over releases of capacity by LDCs to their own retail customers impedes state regulators from ensuring that the local retail customers that pay rates reflecting the full costs of the pipeline capacity in fact gain the benefit of those capacity rights.

LDCs contracted for these capacity rights to provide firm sales service to their local retail sales customers. This retail sales service is subject to the exclusive jurisdiction of the states. Because of FERC's open access pipeline transportation policy, many of these customers now are able to purchase gas from alternative suppliers, but they need to use the pipeline capacity to access alternative suppliers. LDCs and state regulators seek to enable these local retail customers to use the capacity rights the LDC purchased to serve these retail customers through direct releases, unencumbered by FERC's regulation.

FERC's rules interfere with the implementation of state energy policy. FERC's assertion of jurisdiction over capacity releases to local retail customers hampers states in devising optimal mitigation of the firm embedded cost rates paid by LDCs and passed along to firm retail customers. FERC's rules hamper states in crafting programs to enhance local customers' competitive options in the evolving competitive energy markets. The rules interfere with states' ability equitably to allocate the embedded cost of gas transportation to both electricity and gas sold in retail markets.

FERC's regulation, instead, fosters releases of capacity to marketers who often sell to large end-users located out of state. The marketers generally pay only a fraction of the embedded costs of the transportation capacity that are paid by the LDC's residential, small commercial and other firm retail sales customers for whom the capacity is reserved. Thus, the marketers and out-of-state end-users benefit from deep discounts to transportation costs that essentially are paid by the local retail sales customers. In addition, because many

of these out-of-state end-users are electric generators, FERC's rules skew retail energy markets against LDC-supplied gas that bears the full embedded costs of the pipeline's transportation service.

In regulating capacity releases by LDCs to local retail customers, FERC is treading on ground that Congress, in the Natural Gas Act, left to the states to regulate. This Court emphatically and consistently has upheld the principle that the NGA created FERC jurisdiction only over those areas of natural gas transportation and sales that states constitutionally were unable to regulate. Regulation of LDCs' release to local retail customers of transportation capacity purchased to serve those customers is a matter that, under traditional principles of NGA federalism, should be left to the states. FERC has usurped state authority and the court below erred grievously in affirming FERC's decision with respect to this issue.

FERC's rules governing capacity release suffer from the same fatal flaw as the Commission's "Special Marketing Programs" of the mid-1980's, which were remanded by panels of the D.C. Circuit including then Judges Scalia and Ginsburg, in the *Maryland Peoples Counsel v. FERC* cases.[3] The capacity release rules favor large out-of-state end-users, that are not captive to firm gas service, over residential, small commercial and other firm LDC retail customers. These rules stifle development of a robust secondary market in transportation capacity that would benefit all consumers and not just a few favored large volume end-users.

---

[3] *Maryland People's Counsel v. Fed. Energy Reg. Comm'n*, 761 F.2d 768 (D.C. Cir. 1985)("MPC I"), 761 F.2d 780 (D.C. Cir. 1985)("MPC II").

ARGUMENT

THE LOWER COURT'S DECISION UNLAWFULLY ALLOWS FERC TO USURP STATE AUTHORITY TO REGULATE NATURAL GAS DISTRIBUTORS' USE OF PIPELINE CAPACITY PURCHASED TO SERVE LOCAL RETAIL CONSUMERS.

A. The Natural Gas Act Preserved the Full Scope of State Regulatory Authority Over LDCs' Activities to Serve Local Retail Consumers and Extended Federal Jurisdiction Only in Areas Where States Constitutionally Cannot Act.

The NGA, 15 U.S.C. §§ 717-717z, conferred upon the Federal Power Commission, precursor to FERC, the power to regulate certain aspects of interstate commerce in natural gas in order to protect the public interest. This Court has confirmed time and again, most recently in *General Motors Corp. v. Tracy,* that Congress intended not to occupy the entire field of its commerce clause power to regulate commerce in natural gas.[4] Rather, Congress intended to occupy only the

---

[4] *See General Motors Corp. v. Tracy, Tax Comm'r of Ohio*, No. 95-1232, slip op. at 12 (U.S. Feb. 18, 1997)(stating that the Natural Gas Act left "undisturbed the recognized power of the States to regulate all in-state gas sales directly to consumers"); *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n,* 332 U.S. 507, 516 (1947) (holding that the Natural Gas Act did not preempt state regulation of local direct sales by pipelines to industrial users).

portions of the field not subject to state regulation. The Act expressly provides that federal jurisdiction does not extend to "any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution . . ." 15 U.S.C. § 717(b) (Pet. App. at 1007a - 1008a). *See also* 15 U.S.C. § 717(c) (Pet. App. at 1009a). In upholding the Commission's strained expansion of the NGA, the lower court nullifies the exemption provided by the NGA and thereby allows FERC to intrude into areas Congress expressly left to local control.

LDCs historically purchased bundled service that included gas supplies and firm transportation on interstate pipelines to serve residential, commercial and other retail customers with firm energy needs. Because pipelines now transport for many suppliers, LDCs now manage portfolios of gas supplies they purchase from a variety of sources. LDCs must continue to maintain contracts with pipelines for sufficient firm transportation capacity rights to meet the needs of customers that continue to look to the LDC for reliable gas distribution service, especially on the coldest days of the year.

Under FERC-mandated pipeline rate design, LDCs pay an allocation of the full embedded costs of the pipeline capacity reserved to meet the gas supply needs of their customers. These costs in turn are recovered in the LDC's rates to its firm customers. To mitigate these costs and to enhance efficient use of pipeline capacity, LDCs seek to sell to other shippers transportation capacity rights that the LDCs do not need during any given period. When LDCs transfer these capacity rights directly to their own retail customers, the release should not be subject to FERC's encumbering capacity release program. FERC's assertion of jurisdiction over such direct transfers of capacity rights

to local retail customers precludes states from governing how the value of the capacity purchased incident to retail sales service is allocated among the retail customers that are paying to reserve that capacity. FERC's assertion of jurisdiction here has usurped states' authority to regulate the local economic issues entailed in providing reliable retail gas service.

The decision below affirmed FERC's assertion of jurisdiction over LDCs' release of transportation capacity to local retail customers. In so doing, the court failed to give effect to the full measure of state authority in the area, and instead assumed, contrary to this Court's consistent instruction, that the NGA fully occupied the potential scope of federal jurisdiction.

Petitioners have set forth why federal regulation of LDCs' and municipal utilities' management of the capacity rights they purchase to serve their local sales customers and seek to release to local retail customers exceeds the Commission's authority under the Natural Gas Act. The state commissions' petition describes how FERC's regulation impedes states' rights effectively to protect the economic interests of the captive retail consumers of natural gas. A.G.A. supports but will not repeat these arguments; instead we describe how the Commission's regulation has the perverse effect of penalizing precisely the natural gas consumers that the NGA is intended to protect.

B. Competition and Open Access Unbundled Transportation Fundamentally Have Altered Commercial Relationships in Natural Gas Markets, But NGA Jurisdiction Remains Circumscribed by State Authority to Regulate Commerce in the Interests of Local Retail Consumers.

To foster a more competitive natural gas market, Congress passed the Natural Gas Policy Act of 1978 ("NGPA") which removed "first" sales (usually by producers) of natural gas from FERC jurisdiction under the NGA.[4] A competitive spot market in natural gas developed along with a gas futures market to support it. But the wellhead market continued to remain dominated by pipeline purchasers of gas because other purchasers had no meaningful access to the pipeline transportation systems essential to reach consumers. FERC's initial "experimental increase in [natural gas] pipeline competition" was rejected as too narrow by the D.C. Circuit in the *Maryland Peoples Counsel* cases.[5] In those cases, panels led by then Judges Scalia and Ginsburg remanded FERC's "Special Marketing Programs" that had favored industrial end-users of natural gas at the expense of residential and small commercial consumers and thereby harmed rather than helped "the consumers whom the Natural Gas Act was

---

[4] 15 U.S.C. §§ 3301 - 3348 (1994).

[5] 761 F.2d 768, 770 (brackets in original); *see also* 761 F.2d 780, 781 ("[t]his case features [FERC] blanket permission for interstate transportation of natural gas sold directly by producers to end users").

designed to protect." MPC II, 761 F.2d at 781 (internal quotations omitted).

In part responding to these cases, the Commission promulgated rules providing for non-discriminatory, "open access" transportation of gas by pipelines,[6] culminating in the Order No. 636 series, reviewed and remanded in part by the opinion below.[7] Briefly, Order No. 636 prohibited pipelines from selling the commodity gas bundled under a single price with the transportation service required to deliver the gas to the LDC buyer. Instead, Order No. 636 required pipelines to offer all transportation and storage services separately from the commodity, on an "open access" basis to all shippers, including those that buy gas from the pipeline (or the pipeline's marketing affiliate), under nondiscriminatory terms and conditions. The goal of requiring "open-access" transportation unbundled from the gas sale itself, the Commission said, was to "maximize the consumer benefits of the competitive

---

[6] *See General Motors,* slip op at 13-14; *see also* Richard J. Pierce, "The Evolution of Natural Gas Regulatory Policy," Nat. Resources and Env't L.J., Summer 1995 at 53 (providing an overview of the history of natural gas regulation).

[7] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13267, III FERC Stats. & Regs. Preambles ¶ 30,939 (1992) ("Order No. 636") (Pet. App. at 175a - 407a); *Order on Reh'g*, 57 Fed. Reg. 36128, III FERC Stats. & Regs. ¶ 30,950 ("Order No. 636-A) (Pet. App. at 408a - 812a) *Order on Reh'g*, 57 Fed. Reg. 57911, 61 FERC ¶ 61,272 (1992) ("Order No. 636-B") (Pet. App. at 813 a - 998a); *Reh'g Denied*, 62 FERC ¶ 61,007 (1993) ("Order No. 636-C) (Pet. App. at 999a - 1000a), upheld in part and remanded in part, *United Distribution Cos. v. Federal Energy Regulatory Comm'n*, 88 F.3d 1105 (D.C. Cir. 1996) (Pet. App. at 1a - 174a); *order on remand*, 78 FERC ¶ 61,186 (Feb. 27, 1996).

wellhead gas market" by ensuring "that all shippers have meaningful access to the pipeline transportation grid so that willing buyers can meet in a competitive, national market to transact the most efficient deals possible."[8]

The Commission's rules requiring open access transportation and unbundling of the commodity sale from the transportation service allowed the development of a free and open wellhead market in gas commodity sales so that a multiplicity of suppliers could flourish by accessing the robust market of consumers. Now gas markets are at the next step where a robust and resilient secondary market for transportation should develop to maximize efficiency and to enable the benefits of competition to accrue directly to all consumers, not principally to large industrial or electric companies. But FERC's assertion of authority over LDC releases of capacity to local retail customers, like its "Special Marketing Programs," favors large out-of-state end-users who do not need firm LDC service and harms the residential, small commercial and other consumers that need firm supplies and pay for the reserved capacity. The capacity release regulation itself thereby undermines the goal of maximizing the consumer benefits of competition and FERC commits the same error found in the *Maryland People's Counsel* cases.

Under state regulation, LDCs also are instituting a variety of unbundled services for retail customers, enhancing the flexibility of end-users of natural gas to access directly gas being sold in competitive markets. LDCs now routinely serve retail customers that choose to purchase gas from alternative gas suppliers by assisting in arranging for pipeline transportation services

---

[8] Order No. 636, 57 Fed. Reg. at 13281 (Pet. App. at 234a).

and combining those pipeline services with transportation and delivery services on an LDC's system.[9] In many states, LDCs also are offering services such as storage, balancing and standby gas sales on an unbundled basis.[10]

This Court pointed out in *General Motors*, slip op. at 24, that residential and small commercial customers still rely on transportation, distribution and sales service from LDCs bundled together to meet consumers' basic energy requirements, such as space heating.[11] This Court further emphasized that utilities have an *obligation* under state laws to serve these customers' demand. *Id.* at 17-18 & n. 10. LDCs therefore must contract for a sufficient firm daily supply of gas and pipeline delivery capacity to satisfy potential "peak day" needs of these customers, *i.e.* the higher level demand for gas service that occurs when the weather is coldest, even though average daily needs

---

[9] In fact, 81 percent of gas used by industrial customers is purchased from suppliers other than their LDCs, and 25 percent of gas used by commercial customers is purchased from alternative suppliers. Dep't of Energy, Energy Info. Admin., Natural Gas Monthly, Table 24 "Percentage of Total Deliveries Represented by Onsystem Sales, by State, 1994-1995," Jan. 1997 at 64.

[10] *See generally* American Gas Association, "Gas Distribution Industry Pricing Strategies 1995 Update," (FA95-2, Dec. 1995); American Gas Association, "Providing Unbundled Services to Small Volume Customers: Issues to Consider in the Implementation Process," (IB 1996-02, January 5, 1996); American Gas Association, "Providing New Services to Residential Customers: A Summary of Pilot Programs and Unbundling Initiatives," (IB 1996-11, 11A, 11B, 1996).

[11] In addition, certain large customers, such as some apartment buildings, hospitals, industrial plants, etc. continue to prefer firm LDC service.

typically are substantially lower than the potential peak day.[12]

FERC regulates pipeline rates for firm capacity, *i.e.*, capacity that is not subject to interruption, and generally designs firm rates so that all of the fixed costs of the pipeline facilities and business during the course of the year are recovered in the charges that are prorated and paid monthly by the firm customers regardless of how much gas they require to be delivered through the capacity they have reserved. LDCs' rates recover the costs an LDC must pay a pipeline for reserved capacity along with the costs of local delivery facilities and other expenses they incur to serve their customers. State commissions actively oversee these costs to ensure that LDCs are prudent in managing their resources to provide reliable service without overpaying for gas supplies or using pipelines' transportation capacity in an uneconomic manner.[13]

---

[12] In fact a typical residential load factor is only 25%; that is, on an average annual basis, residential customers take only 25% of the gas, or use only 25% of the capacity, that they require on peak and are entitled to take.

[13] *Cf. Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa. Commw. 268, 273-274, 465 A.2d 735, 737-738 (1983) (while states cannot bar regulated utilities from passing through to consumers FERC-approved wholesale rates, states properly review the prudence of LDCs' decisions to incur those costs that are avoidable or discretionary); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 385 (1988)(Brennan, J., dissenting).

C. Including LDCs' Release of Capacity to Local Retail Customers Under FERC's Rule Results in Subsidies to Large Users and Marketers from Consumers That the NGA was Intended to Protect.

Order No. 636 permits LDCs and other holders of firm pipeline capacity to "release" pipeline capacity that currently is not being used to meet customer demand; that is, LDCs may allow third parties to use the capacity when the LDCs are not using it themselves to ship gas.[14] As defined by FERC, capacity release is the "reallocat[ion] [of] unneeded firm capacity" on a permanent or temporary basis.[15]

FERC's rules prescribe a number of cumbersome administrative procedures that not only impede LDCs' ability to use their firm rights to capacity for the benefit of their firm core customers, but also usurp states' efforts to assure the maximum benefit for the LDC customers that need and pay for the firm capacity. First, the capacity must be posted on the pipeline's Electronic Bulletin Board in a certain format and with comprehensive information. Second, the capacity must be sold to the highest bidder at a public

---

14 Order No. 636, 57 Fed. Reg. at 13824 (Pet. App. at 245a).

15 *Id.* at 244a.

auction, subject to a rate cap equal to the pipeline's maximum approved monthly tariff rate.[16] The replacement shipper contracts directly with the pipeline, and pays the pipeline for the transportation service. The pipeline then credits the releasing LDC with the revenues from the new shipper. The LDC releasing the capacity remains obligated to the pipeline for the difference between the release price and the contract demand charge.[17]

Gas marketers won 79 percent of the capacity release awards during 1995 and that number is growing.[18] Marketers combine the released capacity with gas supplies and sell a bundled service to end-users that often are located in other states. The result is that the released capacity -- which was reserved for the use and benefit of the LDC's retail customers -- goes to other parties who do not carry the economic cost of reserving that capacity.

---

16 FERC created two exceptions to the bidding process: 1) if the capacity release was prearranged at the maximum pipeline tariff rate and 2) if the capacity was released for one month or less. 18 C.F.R. §284.243(e) & (h), Order No. 636-A, 57 Fed. Reg. at 36145-46 (Pet. App. at 481a - 485a). Capacity released under these two exceptions to bidding remains subject to the Commission's rate cap. An LDC retail customer may match the highest bid and win the capacity but this is no remedy to the interference by misplaced federal regulation in state programs to enhance competitive purchase opportunities and efficient capacity allocations in local retail markets.

17 Order No. 636, 57 Fed. Reg. at 13284 (Pet. App. at 246a).

18 *See* Interstate Natural Gas Association of America, "Gas Transportation Through 1995," Issue Analysis, Rept. No. 96-3, Sept. 1996 at 8.

The economic harm to the retail customers caused by FERC's rule does not stop there. During most of the year, including the transition months of Spring and Fall, the average rates for released capacity are significantly below the maximum interstate pipeline tariff rates, and therefore significantly below a ratable share of the cost of providing the transportation service. Over the entire 1995-96 winter heating season, which was colder than normal, rates for released capacity nonetheless were discounted an average of 65 percent below maximum tariff rates.[19] During the non-heating season, April through October, capacity release rates were discounted 83 percent.[20] The economic benefit of these deep discounts often goes to the out-of-state dual fuel large users of natural gas or to the marketers serving them, depending upon market conditions.

FERC's rule perpetrates further economic harm to the retail customers who reserve and pay for firm capacity. During the coldest days of the winter, the market value of the released capacity may exceed the maximum approved tariff rate of the pipeline. FERC's monthly rate cap, however, precludes LDCs from recovering the true market value of the capacity to the detriment of the retail customers. The market value of pipeline capacity can be derived from comparing the price of gas in the production area with the price of gas at a particular city gate in markets that are distant from production. For example, in December 1996, the average spot price for gas purchased in Louisiana, a

---

19 Dep't of Energy, Energy Info. Admin., *Natural Gas 1996: Issues and Trends*, December 1996, at 46-47.

20 *Id.*

major supply area, was $3.84 per MMBtu while the average spot price for gas purchased at the New York city gate was $5.22 per MMBtu.[21] The $1.38 difference between the purchase price in Louisiana and the purchase price in New York includes approximately $.24 associated with fuel, and other add-ons that are not part of the value of the transportation. Subtracting these costs leaves $1.14 as the value of the transportation from Louisiana to New York.

Under FERC's rules, however, LDCs may charge no more than the pipeline's maximum tariff rate for released capacity. A typical maximum transportation rate on a major interstate pipeline that extends from Louisiana to New York City is approximately $.31 per MMBtu. Thus the mitigation of the embedded costs paid by the LDCs' sales customers was limited to $.31, while the marketer was able to net an additional $.83 per MMBtu.

Under state law, state regulators are charged with protecting the public interest in energy services at reasonable prices. These matters clearly encompass allocating the value of capacity rights purchased by retail customers -- without interference by FERC regulation. Had FERC not usurped state regulation of capacity reserved for retail sales, the $.83 difference between the maximum tariff rate and the true value of the capacity rights would have been available to mitigate the cost to the in-state customers who paid for the capacity year round if the state so elected. The state could have elected to impose an *annual* revenue cap for released capacity equal to the pipeline's annualized embedded cost rate. State energy policy should govern

---

[21] Brent Friedenberg Assocs., Ltd., *U.S. Northeast Natural Gas Market Review*, December 1996, Table C1, at 28.

allocation of the economic benefit, as well as the capacity itself, that was reserved for local retail sales is resold to local retail customers.

A significant percentage of the out-of-state, large dual-fuel users of released capacity are electric generators. Thus FERC's rule results in subsidies from LDC firm gas sales customers to electric generators. A federal regulation that indirectly requires local gas consumers to subsidize costs of generating electricity wreaks havoc with state efforts to avoid cross subsidies among fuels and is a serious encroachment into the state regulatory domain of integrated resource planning. Moreover, to the extent electric generators using released capacity pay below embedded costs for transportation, LDCs are disadvantaged in competing in retail energy markets because retail gas rates must reflect the share of pipeline embedded costs that electric generators are not paying.

D. States Constitutionally Can Regulate Unbundled Retail Transportation Services and the NGA Left That Authority Undisturbed.

This Court emphatically has defended the breadth of states' authority to regulate public utilities' service to local retail customers against efforts to read the Natural Gas Act as diminishing that authority. Paraphrasing *Panhandle*, 332 U.S. 507, the Court in *General Motors* said:

> Congress's purpose in enacting the NGA was to fill the regulatory void. . . the NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any

> way [T]he scheme was one of cooperative action between federal and state agencies. . . and Congress' action . . . was an unequivocal recognition of the vital interests of the states and their people, consumers and industry alike, in the regulation of rates and service." [Citations omitted.]

General Motors, slip op. at 12 (quoting *Panhandle v. Public Service Comm'n,* 370 U.S. at 519-522).

Historically, LDCs' use of pipeline capacity incident to serving their local retail customers has been subject to strict oversight by state regulatory agencies. The sale by LDCs of transportation capacity rights, separate from the sale of natural gas itself, at the retail level does not change the local nature of the overall transaction -- natural gas service to consumers. Local retail gas service involves issues of critical importance to states, such as adequate supplies and reliable delivery capacity so that consumers are not cut off in cold weather, as well as impacts on the local economy. Congress in the NGA has left those issues to the states and the Court below erred in affirming FERC's preemption of state authority.

LDCs should be permitted to release capacity to customers behind the city gate under terms regulated by the states for the benefit of those customers on behalf of which the LDC reserved the firm capacity and is paying the full embedded costs. Congress in the NGA left to state regulation that which the constitution permits states to regulate. The disposition of rights to move gas to local end-user markets is an area of local concern constitutionally within the states' purview.

CONCLUSION

For the reasons stated, A.G.A. and Citizen urge the Court to grant the petitions for a writ of *certiorari* to the D.C. Circuit in Nos. 96-1186, 96-1187, and 96-1188.

Respectfully submitted,

A. Karen Hill
Counsel of Record
Roger B. Cooper
David J. Muchow
Jane R. Lewis
AMERICAN GAS ASSOCIATION
1515 Wilson Boulevard
Arlington, Virginia 22209
703-841-8465

Richard Vuernick
Edwin Rothschild
CITIZEN ACTION
1730 Rhode Island Avenue
Washington, D.C. 20036
202-775-1580